DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

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Date:

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Contact Person:

ID Number:

Telephone Number:

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Employer Identification Number:

Legend:

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Dear Sir or Madam:

We have considered your ruling request dated a, as modified and supplemented. You (the "Foundation") have requested a series of rulings that certain transactions with related entities are not subject to the taxes on self-dealing under section 4941 of the Internal Revenue Code.

The Foundation was organized and is operated exclusively for charitable, educational, and scientific purposes as a non-profit corporation. The Foundation is a private operating foundation (as defined in section 4942(j)(3)) of the Code exempt from federal income tax under section 501(a) as an organization described in section 501(c)(3).

X is an unincorporated reciprocal interinsurance exchange. Y is a limited partnership that provides data processing and information technology-related products, infrastructure, and services to X and its subsidiaries. Z is a federally chartered savings association and is a wholly-owned subsidiary of X. X, Y, and Z are disqualified persons within the meaning of section 4946 of the Code with respect to the Foundation.

X owns and occupies an office building. X allows the Foundation to occupy a portion of the building without charge. Employees of X occasionally provide certain services on to the Foundation

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without charge. These services include facilitating classroom presentations regarding various safety and/or consumer issues and contributing knowledge and expertise regarding such issues to the Foundation's various publications.

X's Travel Department provides airline, automobile, and hotel reservation services to X and its subsidiaries. The Travel Department proposes to provide these services to the Foundation without charge. The Travel Department receives a commission from airline companies on the price of each airline ticket purchased, excluding taxes and passenger facility charges, and receives a commission from car rental companies and hotels on various automobile and hotel reservations placed. The Travel Department waives its right to earn a commission in the event it can secure a lower rate by doing so.

X will pay for airline tickets and automobile and hotel expenses on behalf of the Foundation. The Foundation will then reimburse X in full. X will not demand any interest or other charge in connection with the reimbursement. This procedure will be followed because X has a special discount arrangement with certain airlines, car rental companies, and hotels. Tickets and automobile/hotel services purchased by the Travel Department are eligible for substantial discounts, whereas those purchased directly by the Foundation are not.

X has entered into an agreement whereby it provides legal, paralegal, accounting, and insurance brokerage services to the Foundation for a specified fee. X's General Counsel Department provides contract development, consultation, and legal opinions on administrative and operational issues. Paralegal services include administrative support to legal counsel such as preparing contracts, legal notices, and coordination of other tasks. X's Financial Services Center provides basic accounting services for the Foundation. The legal and accounting services provided by X are available from external sources at comparable rates.

X's Risk Management Department and the Life Insurance General Agency (the "General Agency") provide risk assessment/risk financing advice and place liability and accident insurance policies with an unrelated party, to cover the Foundation's volunteer staff. The Risk Management Department does not charge the Foundation for its risk assessment/risk financing advice. General Agency does not charge a commission for placing the liability insurance but does charge a commission for placing the accident insurance. The reason for this difference is that the General Agency can purchase the liability insurance directly from the insurer but must go through an outside broker to purchase the accident insurance. General Agency's commission is merely a "pass on" of the outside broker's commission and the amount of the commission is the industry-wide standard commission on this type and size of policy.

Y proposes to provide the following computer support services to the Foundation without charge: catastrophe support, dedicated cellular and pager services, dedicated network connections, dedicated help desk, management of dedicated data repository and utilities, routine service requests (standard form for ordering specific services), and access services (automatic call distribution, local telephone, computer access devices, remote access devices, hardware, communications equipment, and supporting infrastructure).

Z provides FDIC insured deposit services, lending products, and trust services to consumers. Z and the Taxpayer have entered into an agreement whereby Z provides investment services to the Foundation for a specified fee. Z serves as an investment manager, periodically reviewing the Foundation's custodial property and executing the purchase or sale of assets in accordance with the investment objectives of the Foundation. Z serves as an investment advisor, periodically reviewing the Foundation's custodial property and making such recommendations to the Taxpayer as it deems appropriate concerning the purchase or sale of assets. However, Z makes no transaction without prior approval of the Foundation. Z holds the

Taxpayer's custodial property in custody, collects and deposits all income and principal payments with respect to the custodial property, invests assets in various investment vehicles, such as common or preferred stocks and bonds, and issues checks to any payees designated in writing by the Foundation. Pursuant to the Foundation' s agreement, Z receives an annual fee based upon the current fair market value of the assets held.

Pursuant to the Taxpayer's agreement with Z, Z receives an annual fee based upon the current fair market value of the assets held. The fees charged the Taxpayer by Z were established based on the same fees charged to other, unrelated Z customers. According to an analysis performed by the Taxpayer, the fees charged by Z are reasonable, in accordance with industry practice, and permissible under applicable local law governing the activities of fiduciaries. The Taxpayer's assets are invested in four of the mutual funds offered by D and E.

C provides investment advisory services to X and its affiliated organizations and engages in various other investment-related activities. C is a wholly-owned subsidiary of X. F is a division of C which provides brokerage services.

D is a registered investment company that offers shares of nine mutual funds. Its board of directors consists of eight directors, three of whom are also directors of C. The directors are elected by the shareholders of the mutual funds offered by D. Federal securities law requires that at least 40% of the directors be persons who are not "interested persons" with respect to the company, and these outside directors are given specific statutory responsibilities. Each of the nine funds qualifies as a regulated investment company under Subchapter M of the Code. C serves as the manager and investment advisor to all nine funds. It has served as the underwriter for these funds since their inception.

E is a trust and a registered investment company that offers shares of eight mutual funds. E's Board of Directors has eight members, three of whom are also directors of C. The directors are elected by the shareholders of the mutual funds offered by D. Federal securities law requires that at least 40% of the directors be persons who are not "interested persons" with respect to the company, and these outside directors are given specific statutory responsibilities. Each of the nine funds qualifies as a regulated investment company under Subchapter M of the Code. C serves as the manager and investment advisor to all nine funds. It has served as the underwriter for these funds since their inception.

The Foundation's assets are invested in funds offered by D and E (the "Funds"). The Foundation's investment in the Funds is an insignificant fraction of the net asset value of the Funds (about c%). All of the Funds are no-load funds, which means that shares of the Funds are bought and sold at the net asset value of the Funds; no separate fee or commission is paid in connection with the purchase or sale. All other fees are expenses of the Funds and are allocated among all investors/shareholders pro rata. The Funds in which the Foundation's assets are invested are available to the general public and are not controlled by X or any of its affiliates. The investment of X and its affiliates constitute an insubstantial portion of the total net asset value of the Funds (less than b percent) in which investments are made on behalf of the Foundation.

G is a subsidiary of X. It is paid a Transfer Agent Fee, which is a fixed dollar amount per account, payable monthly, by each of the Funds.

Although C will act as Z's investment advisor, it will not act as investment advisor for Z in connection with the Foundation. Instead, C indirectly receives fees from the Foundation by way of the fees paid by the Funds to C as the manager of the Funds. All payments made directly or indirectly to C, F, and G are reasonable and in accordance with industry practice. Neither Z nor C will utilize the Foundation's assets to purchase or cause to be purchased shares of any Fund for the purpose of enabling the Fund to redeem

shares held by X or any of its affiliates.

Section 501 (c)(3) of the Code provides for the exemption from federal income tax of organizations that are organized and operated exclusively for charitable and other exempt purposes.

Section 4941 of the Code imposes an excise tax on each act of self-dealing between a disqualified person and a private foundation.

Section 4946(a)(1) of the Code provides, in pertinent part, that the term "disqualified person" means a person who is: (1) a substantial contributor to the foundation, (2) a foundation manager, (3) an owner of more than 20 percent of the total combined voting power of a corporation, the profits interest of a partnership, or the beneficial interest of a trust or unincorporated enterprise, which is a substantial contributor to the foundation, (4) a member of the family of any individual described above, or (5) a corporation of which persons described above own more than 35 percent of the total combined voting power.

Section 494l(d)(1) of the Code provides that the term "self-dealing" means, in part, any direct or indirect: (1) furnishing of goods, services, or facilities between a private foundation and a disqualified person, (2) payment of compensation (or payment or reimbursement of expenses) by a private foundation to a disqualified person, (3) lending of money or extension of credit between a private foundation and disqualified person and (4) transfer to, or use by or for the benefit of, a disqualified person of the income or assets of a private foundation.

Section 4941(d)(2)(C) of the Code provides that the furnishing of goods, services, or facilities by a disqualified person to a private foundation shall not be an act of self-dealing if the furnishing is without charge and if the goods, services, or facilities so furnished are used exclusively for purposes described in section 501(c)(3).

Section 4941(d)(2)(E) of the Code provides that except in the case of a government official (as described in section 4946(c)), the payment of compensation (and the payment or reimbursement of expenses) by a private foundation to a disqualified person for personal serves which are reasonable and necessary to carrying out the exempt purpose of the private foundation shall not be an act of self dealing if the compensation (or payment or reimbursement) is not excessive.

Section 494l(d)(2)(B) of the Code provides, in part, that the lending of money by a disqualified person to a private foundation shall not be an act of self-dealing if the loan is without interest or other charge.

Section 53.494l(d)-2(d)(3) of the Foundation and Similar Excise Taxes Regulations provides that the furnishing of goods, services, or facilities by a disqualified person to a private foundation shall not be an act of self-dealing if they are furnished without charge. Thus, for example, the furnishing of facilities such as a building by a disqualified person to a foundation shall be allowed if such supplies or facilities are furnished without charge.

Section 53.4941(d)-2(f)(2) of the regulations provides that the fact that a disqualified person receives an incidental or tenuous benefit from the use by a foundation of its income or assets will not, by itself, make such use an act of self-dealing.

Section 53.4941(d)-3(c)(1) of the regulations provides that the payment of compensation (and the payment or reimbursement of expenses) by a private foundation to a disqualified person for the performance of personal services which are reasonable and necessary to carry out the exempt purpose of the private foundation shall not be an act of self-dealing if such compensation (or payment or reimbursement) is not

excessive. For purposes of this paragraph the term "personal services" includes the services of a broker serving as agent for the private foundation, but not the services of a dealer who buys from the private foundation as principal and resells to third parties.

The following examples are set forth in section 53.4941(d)-3(c)(2) of the regulations:

> Example(1). M, a partnership, is a firm of 10 lawyers engaged in the practice of law. A and B, partners in M, serve as trustees to private foundation W and, therefore, are disqualified persons. In addition, A and B own more than 35 percent of the profits interest in M, thereby making M a disqualified person. M performs various legal services for W from time to time as such services are requested. The payment of compensation by W to M shall not constitute an act of self-dealing if the services performed are reasonable and necessary for the carrying out of W's exempt purposes and the amount paid by W for such services is not excessive.
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> Example (2). C, a manager of private foundation X, owns an investment counseling business. Acting in his capacity as an investment counselor, C manages X's investment portfolio for which he receives an amount which is determined to be not excessive. The payment of such compensation to C shall not constitute an act of self-dealing.

Section 53.4941(d)-2(c)(2) of the regulations provides that the lending of money or the extension of credit does not constitute an act of self-dealing if the loan or extension is without interest or other charge.

Section 53.4941(d)-2(c)(4) of the regulations provides that under section 4941(d)(2)(E), the performance by a bank or trust company which is a disqualified person, of trust functions and certain general banking services for a private foundation is not an act of self-dealing, where the banking services are reasonable and necessary to carrying out the exempt purposes of the private foundation, if the compensation paid to the bank or trust company, taking into account the fair interest rate for the use of the funds by the bank or trust company for such services is not excessive. The general banking services allowed by this subparagraph are: (i) checking accounts, as long as the bank does not charge interest on any withdrawals, (ii) savings accounts, as long as the foundation may withdraw its funds on no more than 30 days notice without subjecting itself to a loss of interest on its money for the time during which the money was on deposit, and (iii) safekeeping activities.

The following example is set forth in section 53.4941(d)-3(c)(2) of the regulations:

> Example(3). M, a commercial bank, serves as a trustee for private foundation Y. In addition to M's duties as trustee, M maintains Y's checking and savings accounts and rents a safety deposit box to Y. The use of the funds by M and the payment of compensation by Y to M for such general banking services shall be treated as the payment of compensation for the performance of personal services which are reasonable and necessary to carry out the exempt purposes of Y if such compensation is not excessive.

The provision of office space, knowledge-based employee services, and travel services to the Foundation does not constitute an act of self-dealing because such services are provided to the Foundation without charge. Section 53.4941(d)-2(d)(3) of the regulations.

The Foundation's reimbursement to X of the Foundation's airline tickets and automobile/hotel expenses does not constitute an act of self-dealing because the purpose is merely to reduce the

Foundation's operating costs, and X will not demand any interest or other charge in connection with the reimbursement.

Legal services constitute "personal services" within the meaning of section 4941(d)(2)(E). Section 53.4941(d)-3(c)(2) of the regulations. X's provision of legal services is reasonable and necessary to carrying out the Foundation's exempt purpose, and it is represented the compensation is not excessive in comparison to external law firms' rates. Thus, X's provision of legal services does not constitute an act of self-dealing.

Risk Management's provision of risk assessment/risk financing services, and General Agency's provision of liability insurance placement services, do not constitute acts of self-dealing because such services are provided to the Foundation without charge. Section 53.4941(d)-2(d)(3) of the regulations.

General Agency serves as a "broker" in procuring accident insurance coverage for the Taxpayer's employees. Brokerage services constitute "personal services" within the meaning of section 4941(d)(2)(E). Section 53.4941(d)-3(c)(1) of the regulations. General Agency's services are reasonable and necessary to carrying out the Taxpayer's exempt purpose, and the compensation is not excessive. The commission is merely a "pass on" of the outside broker's commission and is equal to the industry's standard commission. Furthermore, because the commission is a "pass on," General Agency is acting as a mere "conduit" for an outside broker and is not receiving any profit in connection with the transaction. Thus, General Agency's provision of these services does not constitute an act of self-dealing.

Y's provision of computer support services does not constitute an act of self-dealing because such services are provided to the Foundation without charge. Section 53.4941(d)- 2(d)(3) of the regulations.

Z will be compensated for its services in managing the assets of the Foundation. The services to be provided by Z will fall within the term "trust functions" as used in section 53.4941(d)-2(c)(4) of the regulations and within Example 2 of section 53.4941(d)-3(c) of the regulations. The Taxpayer represents in its ruling request that the amount of compensation to be paid to Z is reasonable and we have found nothing which would dispute that claim. Given these facts, we believe that it is reasonable to conclude that the services provided by Z are reasonable and necessary to obtain funds to carry out the exempt purposes of the Foundation.

In regard to the investments of the Foundation in D and E (funds), it is now common for financial institutions such as banks to utilize mutual funds in lieu of common trust funds. Upon the recommendation of the bank and trust company industry, Congress included in the Small Business Job protection Act of 1996 (P.L. 104-188) a provision (new section 584(h) of the Code) permitting tax-free conversion of common trust funds into proprietary mutual funds.

The Joint Committee on Taxation General Explanation of Tax Legislation Enacted in the 104th Congress (Blue Book) explained this new provision:

> The Congress understood that administrative costs of managing pools of assets can be reduced for many banks if the bank utilizes the expertise of professional investment managers employed at mutual funds rather than attempting to duplicate the same investment management services within the bank. The Congress further recognized that generally both common trust funds and mutual funds seek broad diversification of the assets contributed by the investors in the common trust fund or the mutual fund. Because both the common trust and the mutual fund are conduit entities for federal income tax purposes, the Congress believed that it would be inappropriate to impose a tax when the common trust fund transfers substantially all of its assets to one or more RICs, because only the form of

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the investment pool has been changed.

Z is performing trust functions and custodial services for the Foundation and Funds. Furthermore, funds are not controlled by X or any of its affiliates, only an insubstantial amount of D and E's net asset value are from X and its affiliates , and the Foundation's interest in Funds amounts to an insignificant fraction.

In Class Exemption 97-41, 62 F.R. 42830 (August 8, 1997) the Department of Labor (DOL) held that the transfer of the assets of collective investment funds to mutual funds would not be considered a prohibited transaction under section 49475(c)(1) of the Code, even though the same bank acted as investment advisor for the employee benefits plan and as investment advisor for the mutual fund into which the plan assets were transferred, so long as certain conditions are met.

The "prohibited transaction" provisions under section 4975 of the Code are parallel to (and based on) the self-dealing provisions under section 4941of the Code, and the transactions covered by the DOL Class Exemption are closely analogous to the transactions described in this ruling request. If pension plans were involved in these transactions, the Service would be bound by DOL's decision and could not conclude that the transactions are prohibited transactions under section 4975 as long as the terms of the class exemption are satisfied.

Under the facts and circumstances represented, the investment of Foundation assets in funds will not constitute direct or indirect self-dealing under section 4941 of the Code.

C and G are both disqualified persons with respect to the Foundation because they are wholly-owned subsidiaries of X. Since F is a division of C, payments to F are in effect payments to C. Therefore, absent an exception, payment of fees to these entities would be acts of self-dealing. However, the fees paid by the Foundation via the Funds for services rendered by C, F, and G are all reasonable and necessary in order to obtain funds to further the exempt purposes of the Foundation. These activities fall within the exception set forth in section 53. 4941(d)-3(c)(2) of the regulations and are similar to those discussed in Example 2 of that section and are therefore not acts of self-dealing.

Accordingly, we rule as follows:

1. X's provision of office space and certain services to the Foundation without charge do not constitute acts of self-dealing within the meaning of section 4941 of the Code

2. X's provision of legal, accounting, and insurance brokerage services to the Foundation for a specified fee do not constitute acts of self-dealing within the meaning of section 4941 of the Code.

3. Y's provision of computer support services to the Foundation without charge do not constitute acts of self-dealing within the meaning of section 4941 of the Code.

4. Z's provision of investment, advisory, and custody services to the Foundation for a specified fee do not constitute acts of self-dealing within the meaning of section 4941 of the Code.

5. The investment of assets of the Foundation for which Z acts as investment advisor in any of the funds operated by D or E will not constitute an act of self-dealing by Z within the meaning of section 4941.

6. Neither the investment of assets of the Foundation for which C acts as investment advisor in the Funds, nor the fees received by C as investment advisor to the Funds on amount so invested, constitutes an act of self-dealing within the meaning of the section 4941 of the Code. Similarly, the payment of fees of G and F by the Funds do not constitute acts of self-dealing.

7. An investment by X or by any of its affiliates in any of the Funds in which the Foundation invests will not constitute an act of self-dealing within the meaning of section 4941.

This private letter ruling is directed only to the organization that requested it. Section 6110(k)(3) of the Internal Revenue Code provides that it may not be used or cited by others as precedent.

If you have any questions about this ruling, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

Robert C. Harper, Jr.
Chief, Exempt Organizations
Technical Branch 3

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